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Financial Distress and Bankruptcy: Cameroon Micro-Financial Institutions (MFIs)

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ABSTRACT

In this paper we focused to analysis the causes of micro financial sector`s instability and frequent bankruptcy in Cameroon. After a valid theoretical review, we identified three core sector`s destabilizing factors (loan delinquency, competition and limited capital). The regression result noted tense competition as the most influential variable to the shaking state of MFIs. The studied loan delinquency issue also surfaced as a determinant to MFIs bankruptcy. Even though we noted no significant role of limited capital, we believed it has a great contribution, particularly when MFIs are attack by high default. We recommend to the government and regulatory authority to take a step of downsizing at heart. It may create welfare loss, but will help to restore consumers` confidence and make this sector an "oasis" of financial services for the poor Cameroonian again.

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1. Introduction

Micro-Financial Institutions (MFIs) in Cameroon do not only help to upgrade the wellbeing of the low income population but equally it is attracting a huge number of both domestic and foreign investors. This sector is almost dominating commercial banks in providing financial services to the poor inhabitants of Cameroon. Unable to meet up with the demand of the banks especially collateralization. Most low income Cameroonian consider MFIs as their "oasis"[1] . With just 11 commercial bank, serving 23 million Cameroonian, some MFIs turn to provide commercial banks service to fill the need gap. Even with this (present of banks and MFIs), there are many Cameroonian still without account. This unexploited potential and the present of weak regulation (Fotabong et al. January 2016) has stimulate numerous number of MFIS to go operational.

Stability of MFIs is needed to give user`s confidence. Customer required their micro-saving very secure and safe. In addition to safety, a moderate or low interest rate on micro-credit and efficient managerial expertise could give sector a status of "safe haven"[2]. Micro-financial sector will have been superior to commercial banking If these mention issues (safety of saving, encourage interest rate and good management) were in place. However many of its lovers (customers and investors) are reversing their taste. Commercial bank`s stability turn to make some low income earners to prefer it services even at high cost (high interest expense). Some turn to hold their financial resources in personal made serve at respective homes. Cameroonian frequently make this statement "If banks are expensive, and MFIs are not safe what else?" This is the primary puzzle that cause shallow financial system.

But what could be the main issue causing diminishing trust and confidence in the Cameroon`s MF sector? We noted in previous study that loan delinquency is one of the main causes of high MF`s financial distress in Cameroon. It is possible to have loan delinquency and default with survival. Efficient management can help to recover part or some delinquent loan before they turn into bad debt. Also survival is possible provided there is a source of funding (both internal and external sources) to cover shortages. However it cannot be disputed that some major

[1] MFIs actually provide micro banking service to poor Cameroonian which could not be given by banks and other money market institutions. They could only hold their money in real cash without these institutions (MFIs)

[2] Safe haven is a hedge strategy that mitigate risk especially during a specific period like economic depression. Doubt of MFIs will be zero if mitigating tools were in place to reduce or do away with risk.

financial distress and bankruptcy are the result of loan delinquency. This alone cannot be the sole reason for the "ghost" nature of MFIs in Cameroon.

Some of these institutions have good reputation and stable financial records. For example Credit communute de Afrique (CCA), Advance Cameroon, Camccul, Azeri credit union and many others. Their stable nature with many other service (micro insurance and micro transfer) make many customers and members to believe they are unavoidable. But is very easy to realize others MFIs that open their doors today and close one, two or three years later. This was the case of dominion finance, Raven green finance, global finance that went operational between 2008 and 2010 and by 2011 went bankrupt. The deteriorating customer confidence in this sector is cause by only one thing, "frequent news of bankruptcy". Recovering of deposit in case of bankruptcy is never possible considering limited intervention from authority.

Most study including latest publication on MFIs (Fotabong et al. Jan 2016) had focused to analysis loan delinquency in micro financial houses. Evaluating the causes and remedy of default had centered past researches in this domain. This is because authors believe high default rate is the main destabilizer of this sector. In this case addressing this issue and setting a full solution package could liberate the sector. Fotabong et al. (2016) studied Loan delinquency (endogenous variable) and legislation issue, economic down turn and economic contagion (exogenous variables). Boateng and Godwin, F. (2015) investigated on a noticed bankruptcy level of MFIs in Ghana. They recalled in their study the general critics of MFIs institution. These institutions are indeed turning or are profit orientated they noted. They seem to leave the track of the founders, which was center on a socialist philosophy. The pain issue in their paper was to know if actually this institutions are making profit as claim by researchers or critics. And if yes, why such profit making institutions faced with frequent bankruptcy. According to their research model, the root cause of bankruptcy in Ghana`s MF sector is their commercialization nature. And others cause could stem from poor management, regulation and competition in the industry.

A similar study was conducted by Hlupeko, D and Ephraim, M (2015) in Zimbabwe. In a descriptive and exploratory study using questionnaire, this authors analysed the reasons for today`s collapse nature of MFIs. Variables such as competition, administrative cost, diversion form business line, non-performing loans, and poor capitalization were interrogated. They concluded that these factors all have a role to play and should be targeted in order to mitigate

the high bankruptcy rate of Zimbabwe`s MFIs. Beatriz, M. et al. (2010) reviewed variables leading to failure of MFIs in Latin America. Systematic fraud, loss of focus, flaws in credit technology, suffocating government intervention, design flaws in the conception of this institution are among the investigated factors. A failed institution could be cause by more than one of the named variables. They noticed that economic crisis do not necessary leads to collapse of MFIs. However government regulation and political risk have a very high impact to survivability of MFIs.

In this study we will take a similar step to address financial distress and bankruptcy`s specific factors in Cameroon MF sector. In this case the studied loan delinquency (fotabong, et al. Feb, 2016) becomes an exogenous variable. In addition to loan delinquency, limited startup capital and high competition constitute the exogenous variables. The study research on how changes in the named factors can influence distress and bankruptcy of MFIs. Are these institutions real making profit as claimed by many scholars? If yes why is the sector frequently face with a collapse cases? We wish to exploit and know what can be done to keep MFIs a “financial sector`s oasis” or “safe haven” to the low income Cameroonian. The objective of this paper is to investigate the cause of frequent financial distress and collapse of Cameroon`s MFIs. We wish to also provide some remedies to this issue and add some new insight to existing literature.

2. Micro Financial Institutions

A micro financial institutions is one that mobilize micro-saving and grant micro loan primarily to ameliorate the living conditions and the wellbeing of the low income population. These institutions were founded on two principles (group and relationship). In this case they are considered to be more socialist oriented. Today in addition to savings and lending, they can insure (micro insurance) and can do micro transfer of money (Robert C, et al. 2004). Many scholars and micro finance expats today believe that MFIs are deviating from their initial poverty alleviation goal. They seem to be operating from a commercial perspective. Profit orientation turns to make them rivals to commercial banks instead of complementing one another. From this angle their survival with limited capital and instability compare to commercial banks turn to be questionable. In Cameroon these institutions a categorized into class one, two and three based on capital size. Regardless of their critics these institutions still have a major contribution to the wellbeing of the poor population of Cameroon. This class of citizen can own accounts thanks to the operations and existence of micro financial house.

3. Empirical research

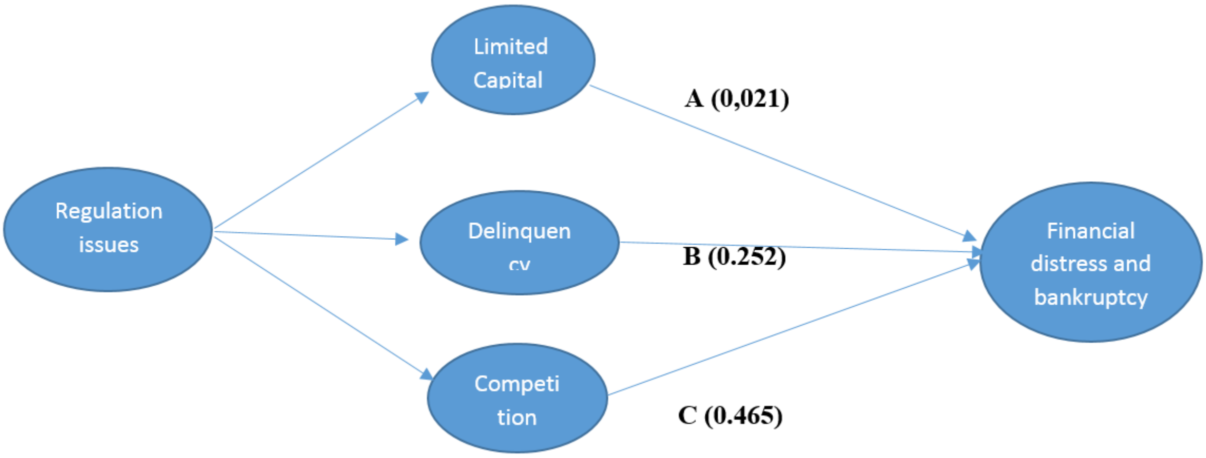

Figure 1
Research model[3] and hypothesis

Regression Equations

MFIs (F.D&C) = Alpha + b1 (Com) + b 2(L.C) + b3 (L.D) + Error.

MFIs (F.D&C) = micro-financial institutions financial distress and collapse, L.D = Loan delinquency, COMP = competition and L.C = limited/low capital.

In addition to regression, we will conduct a correlation analysis

Research Hypothesis

Loan delinquency, sector`s competition and limited capital do not have a significant and positive contribution to MFIs financial distress and bankruptcy. This implies the betas coefficient of each of this variable are not significantly different from zero.

H0a: alpha = 0, H0b: b1 = 0,

H0c: b2 = 0, H0d: b3 = 0,

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[3] Fotabong et, al. Single out regulation issues as the root cause of loan delinquency and noticed no significant contribution of contagion effect and economic down turn. From review we notice a relationship between this identified regulation issue with limited capital and competition. This study take a one more step to relate loan delinquency and other variable with collapse of MFIs. It main focus is to research if delinquency, limited capital and competition rooted from weak regulation stemmed distress and bankruptcy of MFIs in Cameroon.

4. Data Description

a) Variables

The paper analyzes three independent variables (loan delinquency, competition and limited capital) and their relation to financial distress and collapse of MFIs (dependent variable). Loan delinquency in previous study (Fotabong et al January 2016) is identified to be a major issue leading to instability in banks and MFIs. Default payment (both principal and interest) alter the forecasted cash flow and therefore a risk factor. If default rate grow high without substitution or recapitalization, banks and MFIs will be prone to distress or close their doors in severe cases. In a market or sector with competitors, the overall sector revenue will be share among the rival firms. In such a rivalry atmosphere, the weak will be eliminated while the strong will keep going. In our case we believe that the capital size should be the determination factor to distress and bankruptcy in MFIs. Limited capital firm may not be able to embrace the consumer or societal era to its fullest. In this regards may undertake limited promotional, advertisement or conduct limited research. If this is absent in today`s 21st century corporate world, it will be difficult to win the market. Cameroon MFIs seem to be more profit oriented. Therefore enough capital is require to keep them surviving in such a high competitive atmosphere among themselves and with commercial banks. Financial distress occurs when a firm cannot longer meet up with its obligations. When MFIs do not more have fund to meet up with daily withdrawals and settlement of bills, they are forced to begin searching for alternative sources of cash. Severe case of distress will definitely leads to shot of doors (bankruptcy).

b) Sample and Data Sources

We approached the study from primary method. A seven likert scale considering extreme case (never of 0 value and always with a value of 7) will be design and examine. In between these extremes cases are options from strongly disagree to strong agree. The questionnaires will be examine to the management department of 234 MFIs in 5 Cameroon`s regions (South west, Littoral, North West, East Adamawa and central region) of Cameroon. Random class 1, 2 and 3 are all consider in the sample.

c) Descriptive Statistic

The highest average respondent score (4.06) was recorded for loan delinquency. Both the dependent and independent variables recorded a maximum score of 6 and competition is the variable with the least minimum value (0.00)

Table 1
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FD	234	1.00	6.00	3.6810	.94411
COM	234	.00	6.00	3.5550	1.17796
LC	234	.50	6.00	3.8325	1.13434
LD	234	1.00	6.00	4.0646	.98517
Valid N	234				

An analysis of the residual (table 2) clearly corresponds to the normal distribution assumption. The mean of the residual converge to zero with a standard deviation approximate equal 1.

Table 2
Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	1.7549	5.0965	3.6810	.60464	234
Residual	-2.28145	2.17261	.00000	.72510	234
Std. Predicted Value	-3.186	2.341	.000	1.000	234
Std. Residual	-3.124	2.975	.000	.993	234

a. Dependent Variable: FD (financial distress and collapse)

Factor analysis confirm that each of the sample question adequately measure the required variable. Before varimax rotation, two components are identified but the rotation process identified four main components.

Table 3

Factor analysis (Rotated Component Matrix[a])

	Component			
	1	2	3	4
FD&B 1	.544	-.105	.620	.078
FD&B 2	.815	.124	.140	-.039
FD&B 3	.732	.108	.224	.154
COM1	.652	.450	.036	-.025
COM2	.530	.214	.347	.160
LC1	.160	.814	.246	.117
LC2	.190	.839	.153	.036
LD1	.214	.241	.809	.045
LD2	.115	.459	.708	.031
Class	0.90	0.094	0.067	0.978

Extraction Method: Principal Component Analysis.
Rotation Method: Varimax with Kaiser Normalization.
a. Rotation converged in 7 iterations.

Table 4

KMO and Bartlett's Test (Factor analysis)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.842
Bartlett's Test of Sphericity	Approx. Chi-Square	660.714
	df	45
	Sig.	.000

After confirming the significant of all factors through component analysis, merging process (regression`s reduction approach) gives way for the regression result (table 6).

5. Empirical Result

The correlation result below (table 5) has two correlation coefficient that falls below 0.5. The correlation coefficient between limited capital (L.C) and financial distress and bankruptcy is 0.369. Equally 0.465 coefficient is recorded between limited capital and competition (com). We can at this level start to realized L.C to have limited influence on financial distress and bankruptcy. This is quite uncertained on till we observe such result from the regression result.

Table 5
Correlations

Variables	FD&B	Com	L.C	L.D
Financial distress and bankruptcy(FD&C)	1			
Competition(com)	.595**	1		
Limited Capital (L.C)	.369	.465	1	
Loan delinquency(L.D)	.503**	.502**	.520**	1

**, 0.05 (95%) significant level.

Regression outcome actual corresponding and accept the correlation result noted.

Table 6
Regression result[a]

Variables	Com	L.C	L.D	
Coefficients	.452**	.021	.265**	
t-values	7.008	.323	3.959	
Tolerance	.691	.675	.643	
Intercept		.		1.294
R-square				40.2%

**, 0.05 (95%) significant level, a dependent variable = FD&C

Regression Equation and Hypothesis Testing

MFIs (F.D&C) = 1.294 + 0.452** (Com) + 0.021 (L.C) + 0.265** (L.D)

Tracing the root of these factors to weak legislation Fotabong, et al. (January 2016) confirm loan delinquency to be one of the core destabilizing factor in the Cameroon MFIs. This study empirically accepted the tested hypothesis. In effect we found out that as weak legislation stimulate L.D, so too does persistence default and bad debt system stimulate collapse. This hypothesis H0d: b3 = 0 (the effect of loan delinquency on the collapse rate of MFIs) cannot be accepted (0.265, t = 3.959). Similarly, we can reject H0c: b1 = 0 (the effect of competition on the bankruptcy rate of MFIs). Management of 2009 micro financial houses in Cameroon recognized competition to be the core variable of instability. Compare to loan delinquency the coefficient of competition was 0.452 (highest). This issue is tense because the sector is not only competing within but equally with money market institutions as a whole. Base on the management, MFIs do not actually suffer from limited capital problem. They believe capital inadequacy is not really the problem to distress and bankruptcy. H0c: b2 = 0 (The role of limited capital on financial distress and collapse) cannot be rejected.

To our understanding, we strongly believe management are bias or critical towards responding to the tags corresponding to limited capital. And we have had as a limitation to conduct an ex-post collapse cases. We strongly believe extant study cannot fully review the reasons why MFIs collapse but can review factors why they may collapse. Given the limitation (figure out and find management of collapsed institutions) we are limited to conduct an extant research nature. To management who believe they meet up their respective minimum class capital requirement, capital inadequacy may no longer be a threat to their going concern. This thought is of course logical however consider a class 1 micro-finance institutions that have turn profit oriented. Place such institutions in a high competitive sector of that nature and with large capital size commercial banks. They will be no doubt that they may moderate interest to serve their interest and survival which has a question on survival. This question may also be responded to when this institution are not attacked by loan delinquency. The effect of limited capital becomes much pronounce when these institutions are attacked by high default rate. In this angle we are statistically accepting H0c: b2 = 0, which entails limited capital is not actually the cause of collapse. But practical we reject this hypothesis and acknowledge it a major issue in Cameroon micro-financial institutions for the following reasons.

- Management bias responds. Management always want to prove they work with the law and have kept the minimum capital require. This notion may leads to bias in responds.
- Extant study may not be able to trace the actual cause of failure. If firms can secure more capital after mismanagement or high default, they will keep operational except otherwise. Therefore an ex-post respondent approach could show the role of limited capital to bankruptcy than extant.
- The fact that firms keep the minimum capital requirement does not means they have enough capital to survive intense competitive sector like MF sector in Cameroon.
- Weak regulation have given many of such institution an opportunity to go operation without keeping the minimum capital requirement.

For these reasons, “**limited capital that is attacked by loan delinquency in micro-financial firms that are operating in a tense and high competition is equal to bankruptcy**”.

6. Conclusion

This study is aimed to investigate the cause of MFIs collapse in Cameroon. It figures three variables (loan delinquency, limited capital and competition) rooted from weak regulation (figure 1) as the testable predictors. To get into a sample regression analyses a factor analysis to validate the respective question tag was conducted. After confirming and merging of questions into three core determinant we conducted a regression and correlation test. Statistically, two factors (loan delinquency and competition) are proven significant. However using the limitation of the study (The inability to have management of collapsed MFIs as sample respondents) and other justification make us to justify limited capital as equally has an influence. Management of Cameroon MFIs strongly believe that the instability in the sector is mostly influenced by tense competition.

We wish the micro financial institutions with little capital particularly the class 1 to stick to the core concept of MFIs (not for profit making but poverty alleviation). This will make them not rivals to commercial banking. We equally recommend to the regulatory authority to raise the minimum capital requirement and downsize the total number of MFIs operating in the system. That is any institution not able to meet the new limit should close or merge with others. This process can definitely harden entering. If the ease of entering is reduce, this will equally reduce the ease of going out (bankruptcy). A special agent, center to shot down illegal MFIs should be set. If in place even though it may leads to a welfare loss, it can help to restore customers confidence as instability can highly be reduce.

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